

STATE OF CALIFORNIA  
**ELECTRICITY OVERSIGHT BOARD**



Gray Davis, Governor

September 17, 2001

Mr. David P. Boergers, Secretary  
Federal Energy Regulatory Commission  
888 First Street, NE  
Washington, D.C. 20426

VIA HAND DELIVERY

**Re:   Huntington Beach Development Company, L.L.C.**  
**Docket No. ER01-2390-000**

Dear Mr. Boergers:

Enclosed please find an original and fifteen copies of the Joint Request for Rehearing of the California Electricity Oversight Board and the California Public Utilities Commission of the Commission's August 17, 2001 Order Conditionally Accepting Market-Based Rate Tariff in the above-referenced docket. Please file-endorse the extra copy to be retained by the delivery agent.

Thank you for your assistance.

Sincerely,

Lisa V. Wolfe, Staff Counsel  
California Electricity Oversight Board

Enclosures

cc: Official Service List of ER01-2390

**UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION**

Huntington Beach Development, LLC

Docket No. ER01-2390-000

**JOINT REQUEST FOR REHEARING OF THE CALIFORNIA ELECTRICITY  
OVERSIGHT BOARD AND THE CALIFORNIA PUBLIC UTILITIES  
COMMISSION OF THE AUGUST 17, 2001 ORDER CONDITIONALLY  
APPROVING MARKET-BASED RATE TARIFF**

Pursuant to Section 313 of the Federal Power Act (“FPA”) and Rule 713 of the Commission’s Rules of Practice and Procedure<sup>1</sup>, the California Electricity Oversight Board (“Board”) and the California Public Utilities Commission (“CPUC” and, collectively with the Board, the “California Parties”) hereby submit their joint request for rehearing of the Federal Energy Regulatory Commission’s (“Commission’s”) August 17, 2001 Order Conditionally Accepting Market Based Rate Tariff (“August 17 Order”) in the above-captioned docket.

**I. INTRODUCTION AND SUMMARY**

The August 17 Order conditionally accepted for filing, without suspension or hearing, the proposed market-based power sales tariff and code of conduct filed by Huntington Beach Development, L.L.C. (“HBD”) on June 20, 2001<sup>2</sup> and granted HBD’s requests for certain blanket waivers and authorizations under various Commission regulations. The August 17 Order grants HBD market-based rate authority for the sale of energy and capacity from two repowered units (3 and 4) at the AES Huntington Beach generation facility totaling 450 MW.

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<sup>1</sup> 16 U.S.C § 825(a) (1994); 18 C.F.R. § 385.713 (2000)

<sup>2</sup> See “Application of Huntington Beach Development, L.L.C for Market-Based Rates, Request for Expedited Consideration, Request for Notice Waiver and Alternative Effective Dates, and Request for Waivers,” filed with the Commission on June 20, 2001 (“HBD Application”).

The California Parties filed protests in this proceeding on July 11, 2001, objecting to HBD's market-based rate application.<sup>3</sup> The Board Protest and the CPUC Protest were framed in recognition of two important and competing concerns. First, the California Parties recognized the critical need to quickly bring additional generating capacity into California's energy markets during a peak demand period – a laudable goal of the HBD Application. However, balanced against this need for additional generating capacity rests the pervasive fact of life in California's dysfunctional wholesale energy markets – public utility sellers have exercised, and have the potential to continue to exercise, market power resulting in unjust and unreasonable rates for California consumers.

The California Parties maintained in their protests, and continue to maintain, *inter alia*, that the HBD Application relies on an outdated Commission hub-and-spoke/time-averaged market share methodology that fails to adequately assure the lack of, or adequate mitigation of, market power. In light of these concerns, the California Parties presented their objections to the HBD Application, and requested the Commission require HBD to file an application for cost-based rates and to set the matter for hearing.<sup>4</sup> However, in recognition of the need to expedite additional available generating capacity to meet peak summer loads, the California Parties requested the Commission accept the proposed market-based rate filing (pending grant of cost-based rate authority to HBD), but with a nominal suspension such that rates would be subject to refund. Refund potential would provide at least some level of protection for California consumers pending Commission hearing and determination of appropriate cost-based rates.

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<sup>3</sup> See "Motion of the California Electricity Oversight Board to Intervene and Protest" ("Board Protest") and "Notice of Intervention, Protest and Request for Hearing of the Public Utilities Commission of the State of California" ("CPUC Protest"), both filed in this proceeding on July 11, 2001.

<sup>4</sup> See Board Protest at 7 and CPUC Protest at 11.

As noted above, the Commission accepted the HBD Application for filing, but did so without suspension or hearing. While the August 17 Order enables the availability of some badly needed additional generating capacity in California, the unacceptable side effects are continued exposure of California consumers to the potential for unjust and unreasonable rates and continued Commission failure to meet its responsibility to ensure sellers into California's wholesale energy markets adequately demonstrate lack of or adequate mitigation of market power. Specifically, the August 17 Order errs and is arbitrary and capricious by:

- Relying upon an outdated and ineffective methodology to assess market power in California's wholesale energy markets;
- Failing to adequately consider the ability of HBD, in conjunction with other units owned by AES entities, to exercise market power;
- Relying upon a factually incomplete record;
- Relying upon quarterly transaction reporting requirements to provide ongoing monitoring of the ability to exercise market power;
- Relying upon certain prior Commission orders as justification for grant of market-based rate authority; and
- Failing to take official notice in this docket of evidence establishing the existence and exercise of market power in the markets in which HBD and its AES affiliates will and do operate. Such evidence is directly relevant to whether HBD may be authorized to make sales at market-based rates.

## **II. THE AUGUST 17 ORDER IS ARBITRARY AND CAPRICIOUS IN THAT IT RELIES ON AN OUTDATED INEFFECTIVE METHODOLOGY TO ASSESS MARKET POWER**

The Commission's traditional test for the ability of a market participant to exercise generation market power – the “hub-and-spoke” approach and overall time-averaged market share with a 20% threshold for concern<sup>5</sup> – is entirely ineffective to determine whether sellers into California's wholesale energy markets lack or have adequately mitigated market power.

One reason that the Commission's methodology fails is that California's energy and, particularly, ancillary services markets function as a series of time-segregated markets. Overall time-averaged market share does not and cannot adequately predict the ability of a market participant in California's markets to exercise market power on a recurring basis during periods of peak demand and tight supply. The exercise of market power is of particular concern under conditions of peak demand – the very conditions under which HBD would provide additional energy and capacity (see HBD Application at 1). The Board, the CPUC and the CAISO raised this concern to the Commission over three years ago.<sup>6</sup> The attached report prepared for the Board by Dr. Steven Stoft, “An Analysis of FERC's Hub-and-Spoke Market Power Screen,” contained in Appendix A, further examines this and other problems inherent in the Commission's traditional hub and spoke/time-averaged market share methodology. Dr. Stoft's report demonstrates that this methodology is entirely ineffective for energy markets, illustrating this point for both

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<sup>5</sup> See e.g., *Louisville Gas & Electric Co.*, 62 FERC ¶ 61,016 (1993); *Entergy Services, Inc.*, 58 FERC ¶ 61,234 (1992); and *Public Services Company of Indiana, Inc.*, 51 FERC ¶ 61,367 (1990).

<sup>6</sup> See, e.g., “Motion to Submit Out-of-Time Comments and Protest of the Public Utilities Commission of the State of California,” Docket No. ER98-4498 and “Motion to Intervene and Preliminary Comments and Answer of the California Electricity Oversight Board in Support of the Emergency Motion for Stay, Request for Rehearing, and Motion for Clarification of the California Independent System Operator Corporation”, Docket Nos. ER98-2843-001 et al.

the California energy market as well as the Pennsylvania-New Jersey-Maryland (“PJM”) market.

The tumultuous events in California’s troubled wholesale energy markets evidence the fact that the hub and spoke methodology is not an effective market power screen. The Commission itself has recognized over the past year that sellers in California’s wholesale electric markets have the potential to exercise market power. The Commission has acknowledged that: “...the electric market structure and market rules for wholesale sales of electric energy in California are seriously flawed and that these structure and rules, in conjunction with an imbalance of supply and demand in California, have caused, and have the potential to cause, unjust and unreasonable rates for short-term energy...under certain conditions,” and that “...there was clear evidence that the California market structure and rules provide the opportunity for sellers to exercise market power when supply is tight and can result in unjust and unreasonable rates under the FPA.”<sup>7</sup> Moreover, numerous reports have been filed by the CAISO, the CPUC and others providing substantial evidence of market power abuse in California’s wholesale energy markets.<sup>8</sup>

Yet, these same public utility sellers were originally granted market-based rate authority under the Commission’s current market power screen, and seek renewal or extension of that authority under the same ineffective test. Continued Commission

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<sup>7</sup> See “Order Directing Remedies for California Wholesale Electric Markets,” 93 FERC ¶ 61,294 (2000), slip op. at 41.

<sup>8</sup> See, e.g., CPUC Protest at 8, n.3 and n.4. See also: “Further Analyses of the Exercise and Cost Impacts of Market Power in California’s Wholesale Energy Market,” attached as Exhibit B to Intervention and Protest of the California Independent System Operator Corporation, Docket No. ER99-1722-004 (April 9, 2001); “Empirical Evidence of Strategic Bidding in California ISO Real-time Market,” attached as Exhibit C to Intervention and Protest of the California Independent System Operator Corporation, Docket No. ER99-1722-004 (April 9, 2001); and “Impacts of Market Power in California’s Wholesale Energy Market: More

reliance on its current market power screen both in granting and renewing market-based rate authority for sellers into California's wholesale energy markets amounts to little more than a rubberstamp approach and is arbitrary and capricious.

Several Commissioners themselves recognize that the Commission's market power analysis methodology is in dire need of repair and that it cannot provide a reasoned basis for continued grant of market-based rate authority to public utility sellers. In his dissenting opinion in the August 17 Order approving the HBD Application, Commissioner Massey states:

In this order, the Commission once again relies on an anachronistic and unreliable analytic standard to assess market power for the purpose of granting market-based rates, and for that reason I must dissent. The Commission allows market-based pricing based on the results of our standard old-fashioned hub-and-spoke analysis and a 20 percent market share threshold for concern. Because this methodology is so unreliable and provides the Commission with inadequate data on the true scope of electricity markets, the Commission simply does not have sufficient evidence of lack of market power and cannot make a reasoned decision based on the present record. [August 17 Order, Commissioner Massey, dissenting at 1].

Commissioner Massey, in his dissenting opinion in Sierra Pacific Power Company, 95 FERC ¶ 61,059 (2001), has previously elaborated upon his views about the legal insufficiency of the hub-and-spoke methodology:

... the Commission continues to rely on an outdated and unreliable analytic standard to assess market power for the purpose of granting market-based rates ... Because this analytic method is so unreliable, the Commission has no basis upon which to make a reasoned determination whether the marketer will be able to exercise market power ... little or no account is taken of the important factors that determine the true scope of electricity markets, such as physical limitations on market size including transmission constraints, prices, costs, transmission rates, and the variance of supply and demand over time. Virtually no seller ever fails this screen,

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Detailed Analysis Based on Individual Seller Schedules and Transactions in the ISO and PX Markets” (April 9, 2001).

and thus it is no screen at all.” [Sierra Pacific power Company, Commissioner Massey, dissenting at 1].

Commission Brownell, in a concurring opinion in the August 17 Order, agrees with Commissioner Massey’s characterization of the hub-and-spoke methodology as being outdated and unreliable. (August 17 Order, Commission Brownell, concurring at 1). Also, press reports of the July 11, 2001. Commission meeting indicate that Commissioner Wood and Commissioner Brownell share Commissioner Massey’s concern with the outdated hub-and-spoke methodology. As noted by Commissioner Massey, the concerns of these Commissioners belie the statement made in the August 17 Order that “...at this point, we are not prepared to abandon the hub-and-spoke analysis in favor of another market analysis framework.” (August 17 Order, Commission Massey, dissenting at 1.)

Of particular note, a plea for expedited consideration filed on behalf of applicant HBD, dated August 17, 2001, recognizes that “the concerns that have been raised by the intervening parties are issues across the board for sellers under market-based rates and call for a generic change in analysis to be applied to all applicants for market-based rates. Despite the ongoing discussion as to the appropriate analysis, the Commission has continued to grant market-based rate authority to applicants....AES respectfully requests that its application be considered and approved on the same basis as has been applied to many others similarly situated.”<sup>9</sup> AES Corporation and HBD do not disagree that a sweeping change in Commission methodology and standards to assess market power is warranted. Rather, their concern is that they be afforded the same application of the Commission’s pseudo-standard as have other applicants. In granting HBD’s market-



based rate authority the same day as this request, without suspension or hearing, the Commission unfortunately obliges this irresponsible approach to perpetuate the application of an inappropriate standard.

Continued blanket reliance by the Commission on the incurably flawed hub and spoke market power screen to grant market-based rate authority is arbitrary and capricious, particularly in light of substantial evidence that sellers who have passed this screen exercise market power and the acknowledgement by Commissioners themselves (as well as applicants themselves!) that this methodology is no longer acceptable.

### **III. THE AUGUST 17 ORDER IS ARBITRARY AND CAPRICIOUS IN FAILING TO ADEQUATELY CONSIDER THE ABILITY OF HBD AND ITS AES AFFILIATES TO EXERCISE MARKET POWER**

Notwithstanding the foregoing position of the California Parties that continued reliance on the Commission's current market power assessment methodology is arbitrary and capricious, the Commission errs in granting market-based rate authority to HBD even under the traditional hub-and-spoke methodology – HBD fails the existing test.

FERC incorrectly applied even its current, ineffective market power screen. As demonstrated by HBD Application, HBD and its AES affiliates own 27.4 percent of the uncommitted capacity in the hub-and-spoke analysis and 36.6 percent of uncommitted capacity in the Southern California market.<sup>10</sup> Both are well above the Commission's 20 percent benchmark.<sup>11</sup> AES does not dispute the accuracy of these numbers, arguing only that an analysis of its market power should not include units which are owned by AES

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<sup>9</sup> Letter dated August 17, 2001, to Chairman Hebert and Chairman Designate Wood Re: Huntington Beach Development, L.L.C., Docket No. ER01-2390, at Page Two.

<sup>10</sup> See HBD Application, Affidavit of J. Stephen Henderson, Exhibits JSH-4c and JSH-5c.

<sup>11</sup> See CPUC Protest at 9.

but dispatched by Williams Energy Marketing & Trading Company (Williams).<sup>12</sup> But, as the CPUC demonstrated, it is necessary to include such capacity in an analysis of AES' market power.<sup>13</sup> AES owns the capacity, and its contract with Williams could enable AES to circumvent attempts to limit the market power of AES and Williams. Since HBD and its affiliates admittedly own capacity far in excess of the Commission's standard for authorizing market based rates, the application must be rejected and the relief sought in the California Parties' protests granted.

#### **IV. THE AUGUST 17 ORDER IS ARBITRARY AND CAPRICIOUS IN RELYING UPON A FACTUALLY INCOMPLETE RECORD**

The August 17 Order inappropriately ignores the issue of whether or not Williams will market and dispatch the output from the repowered units 3 and 4 at the Huntington Beach generating facility. This issue developed as a factual dispute in the underlying record and remained unresolved at the time of issuance of the August 17 Order and is not addressed by that order. On August 17, 2001, HBD filed its "Reply of Huntington Beach Development, L.L.C." in Docket No. ER01-2390-000, requesting that the Commission not delay grant of market-based rate authorization to HBD over the "collateral and highly speculative" issue of whether or not Williams' has a contractual right to market and dispatch the output from the HBD repowered units.<sup>14</sup> Obviously, the Commission obliged this request of HBD and granted HBD market-based rate authority the same day, August 17, 2001.

The California Parties disagree that the issue of Williams' role in the marketing and dispatch of output from HBD units is merely a collateral issue. The Commission errs

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<sup>12</sup> July 23, 2001, "Answer of Huntington Beach Development, L.L.C." at 5 n.11, Docket No. ER01-2390-000.

<sup>13</sup> CPUC Protest at 8-9.

in not mandating resolution of this issue in the underlying record. The *existing* tolling agreement between Williams and AES may be ultimately construed to cover the output from units 3 and 4 and HBD does not deny this potential outcome.<sup>15</sup> However, the California Parties, among others, have protested renewal of market-based rate authority for Williams and provided evidence that Williams already exercises market power in California's wholesale energy markets.<sup>16</sup> Under such circumstances, it is entirely inappropriate for Williams to accrue an additional 450 MW of capacity for marketing and dispatch, particularly at peak demand times. Although, as HBD states, this tolling agreement is on file with the Commission,<sup>17</sup> this meager fact provides no protection whatsoever for California consumers against the potential for Williams' charging unjust and unreasonable rates for output from these units.

Moreover, the Commission, in its apparent haste to rubberstamp yet another public utility seller into California's energy markets, entirely overlooks the fact that under the Williams' contract scenario, as presented in the HBD Application, Williams significantly exceeds the current Commission 20% threshold for market-power (inapposite as it is) to the tune of 22.3% for uncommitted capacity in the SCE hub-and-spoke market and 29.8% uncommitted capacity in the southern California market.<sup>18</sup> Yet, the Commission somehow simply ignores the issue in the underlying record as to whether

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<sup>14</sup> August 17, 2001, "Reply of Huntington Beach Development, L.L.C." at 5.

<sup>15</sup> *Id.* at 4-5, n.13.

<sup>16</sup> See "Joint Emergency Motion of the California Electricity Oversight Board and California Public Utilities Commission for Immediate Suspension of Market-Based Rate Authority and for the Institution of Refund Proceedings" filed in Docket No. ER99-1722-004 on May 29, 2001. See also "Emergency Motion of the California Independent System Operator Corporation for Immediate Suspension of Market-Based Rate Authority, for the Institution of Refund Proceedings, and Request for Shortened Time to Answer" filed in Docket No. ER99-1722-004 on May 25, 2001, and "Motion for Leave to Intervene Out-of-Time and Emergency Motion of the People of the State of California *ex rel* Bill Lockyer for Immediate Suspension of Market-Based Rate Authority and for the Institution of Refund Proceedings" filed in Docket No. ER99-1722-004 on May 31, 2001.

<sup>17</sup> August 17, 2001, "Reply of Huntington Beach Development, L.L.C." at 4-5, n. 13.

Williams' contract arrangements with HBD affiliates allow it to attain an additional 450 MW of energy and capacity, earmarked for sale to California consumers during times of critical need. The Commission is arbitrary and capricious in not addressing and requiring resolution of this issue in the HBD proceeding.

**V. THE AUGUST 17 ORDER IS ARBITRARY AND CAPRICIOUS IN RELYING UPON QUARTERLY TRANSACTION REPORTING REQUIREMENTS TO PROVIDE ONGOING MONITORING OF THE ABILITY TO EXERCISE MARKET POWER**

The California Parties observe that the events in California's wholesale energy markets, marked by the well-documented evidence of the exercise of market power, evidence the shortcoming of relying on the Commission's quarterly transaction reporting requirements as an effective ongoing market monitoring mechanism. The California Parties agree with Commissioner Massey's statements in his dissenting opinion in the August 17 Order regarding the Commission's quarterly reporting requirements. (August 17 Order, Commissioner Massey, dissenting at 2-3).

**VI. THE AUGUST 17 ORDER IS ARBITRARY AND CAPRICIOUS IN RELYING UPON CERTAIN PRIOR COMMISSION ORDERS AS JUSTIFICATION FOR GRANT OF MARKET-BASED RATE AUTHORITY**

The Commission errs in relying upon its orders of December 15, March 9, April 26, and June 19, and July 25 in Docket Nos. EL00-95-000 et al., as justification for grant of market-based rate authority to HBD. (August 17 Order, slip op. at 4). As noted by Commissioner Massey in his dissent, the price mitigation measures in those orders extend only until September 30, 2002, but the market-based pricing approved for HBD extends beyond that date. (August 17 Order, Commission Massey, dissenting at 2).

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<sup>18</sup> HBD Application, Affidavit of J Stephen Henderson, Exhibits JSH-4c and JSH-5c.

Conditions in California’s wholesale energy markets are not competitive (as acknowledged by the Commission) and the actual effectiveness of the Commission’s latest price mitigation measures is yet to be determined. The Commission is authorized to “rely upon market-based rates in lieu of cost-of-service regulation to assure ‘just and reasonable’ result” only “when there is a competitive market.” Elizabethtown Gas Co. v. FERC, 10 F.3d 866, 870-71 (D.C. Cir. 1993).

California has been entangled in this successive string of Commission orders since December 2000 that have been ineffective in ensuring workably competitive conditions and securing just and reasonable rates. “Without empirical proof” that the market will constrain rates to levels that are just and reasonable (*Farmers Union Cent. Exchange v. FERC*, 734 F.2d 1510 (D.C. Cir. 1984)), and without “substantial evidence upon the basis of which the Commission could conclude that market forces will keep...prices in check” (*Texas Power Corp v. FERC*, 905 F.2d 1005 (D.C. Cir. 1990)), the Commission may not, as a matter of law, permit the continuation of market-based rates.

**VII. THE AUGUST 17 ORDER ERRS IN FAILING TO TAKE OFFICIAL NOTICE OF EVIDENCE IN DOCKET NOS. EL00-95-000 ET AL., ESTABLISHING THE EXERCISE OF MARKET POWER**

The Commission’s decision to refuse to take official notice of evidence in Docket Nos. EL00-95-000 et al., is arbitrary and capricious. As stated in the CPUC Protest:

It would be senseless for FERC to require resubmission in this docket of the various reports, testimony, affidavits, and related filings which establish the existence and abuse of market power in the California markets which have been provided in the San Diego Gas & Electric Company dockets. The material is available to FERC and its staff in FERC’s official files, is clearly relevant to the decision to

be made in this docket, and can be relied on by FERC in this docket. CPUC Protest at 11.

The Commission rejected the request, stating that the record in Docket Nos. EL00-95-000 et al., consists of over 1,000 separate submittals and asserting that the CPUC had not identified “any specific documents that it believes are relevant to this proceeding.” August 17 Order, slip op. at 2, n.2. The Commission’s articulated rationale for rejecting the request has no merit.

First, the simple fact that the record in Docket Nos. EL00-95-000 et al., is large does not excuse the Commission from considering it. This docket is the lead docket for market power issues arising from the extraordinary crisis in western electric markets over the past year. The Commission and its staff are well aware of that record. The CPUC has not requested that the Commission take official notice of a large record which is not easily available to it—it has simply asked the Commission to take the administrative step of incorporating relevant material already filed at the Commission into this record, to avoid the need to re-file relevant material already available to it. The Commission has determined in a series of orders within this docket that market power was exercised in California—where HBD will operate, and where its affiliates currently operate—and that refunds must be paid to California buyers for unjust and unreasonable rates charged in California markets. It is clearly arbitrary and capricious to grant market-based rate authority to HBD without reference to the context in which HBD’s application was made. That context is the record in Docket Nos. EL00-95-000 et al.

Second, the CPUC did identify specific materials in the record for Docket Nos. EL00-95-000 et al., which the Commission ought to have considered in this proceeding. While the Commission should have taken official notice of the entire record in Docket

Nos. EL00-95-000 et al., there is no excuse for the Commission's failure, at a minimum, to take official notice of such specific material, which includes:

- the CPUC's November 22, 2000 Comments filed in Docket No. EL00-95-000;
- the CAISO's November 22 Comments in Docket no. EL00-95-000;
- the CAISO's An Analysis of the June 2000 Price Spikes in the California ISO's Energy and Ancillary Services Markets;
- Joskow/Kahn, A Quantitative Analysis of Pricing Behavior in California's Wholesale Electricity Market During Summer 2000, submitted in Docket No. EL00-95-000 by Southern California Edison Company; and
- the CAISO's March 22, 2001 filing in EL00-95-012, and particularly Attachment C to that filing, a study entitled "Empirical Evidence of Strategic Bidding in California ISO Real Time Market," showing the extent of market power exercised by each of the in-state owners of divested thermal generation, and the manner in which each generator, manipulated their bids to exercise that market power.

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## VIII. CONCLUSION

Based upon the foregoing, the Commission's August 17 Order is arbitrary and capricious and the Commission errs in not providing the relief requested by the California Parties in the CPUC Protest and the Board Protest filed with the Commission in this proceeding.

Dated: September 17, 2001

Respectfully submitted,

LISA V. WOLFE

By:

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## **CERTIFICATE OF SERVICE**

I hereby certify that on September 17, 2001, I served the foregoing document upon each person designated on the official service list for this proceeding compiled by the Secretary.

Dated at Sacramento, California, this 17<sup>th</sup> day of September 2001.

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## **APPENDIX A**